

**STATEMENT OF AMERICAN COUNCIL OF LIFE INSURERS
JOHN P. GERNI, REGIONAL VICE PRESIDENT
BEFORE THE MICHIGAN HOUSE INSURANCE COMMITTEE
FEBRUARY 9, 2012**

Good afternoon, Chairman Lund and members of the Committee. Thank you for providing me with the opportunity to discuss concerns regarding Stranger Originated Life Insurance (STOLI) and its abusive practices to seniors.

Life Insurance has for centuries been respected as a valuable financial instrument, protecting families and businesses from the financial devastation caused by untimely death. Responsible productive members of society, with dependents who would be faced with economic hardship if they die unexpectedly, need life insurance in order to minimize that risk. While there are some useful benefits of life settlements, I'd like to focus on a subset of life settlements that puts in force a life insurance policy for the sole purpose of ultimately transferring the death benefits to the investment market. This Stranger Originated Life Insurance, known as STOLI is designed to provide profits to investors and the intermediaries who conduct such business. State law requires and public policy necessitates that there be an "insurable interest" in the continued life of the insured for the lawful contracting of life insurance. STOLI, however, flips that on its head, and the speculators who purchase the policies have an interest only in the death of the insured, with the highest return directly tied to early deaths.

Let me take a moment to describe how these transactions work:

An agent approaches a senior offering a large life insurance policy, with “free insurance” for 2 years, and usually accompanied by other financial incentives such as cash.

- **A life expectancy evaluation is arranged so that the investment speculator can cherry pick those with the shortest life expectancy enabling them to arbitrage the average pricing assumptions of the insurer.**
- **Financing is arranged to pay the premiums, with a promise of no cost to the senior.**
- **A trust, sub-trust or other increasingly obscure entity is created to hold the ownership and beneficiary interests in order to mask the true intent of the deal.**
- **At the end of the 24 month contestability period, the senior can repay the loan (several hundred thousand dollars in premiums, plus top-of-the-market interest rates) or sign over the policy as full repayment for the loan. It is expected that the policy will be signed over at this point. In fact the financing is usually only provided for 2 to 3 three years. Two years is a critical point, as the insurance company is generally prohibited from voiding the coverage on the basis of misrepresentation on the application after two years. Thus, most transfers occur after this period so that the investor has no risk of the policy being rescinded.**
- **The policy is then packaged into a “death bond” and sold to investors. As part of the scheme, the senior agreed to calls/visits every three months to monitor their life status, and if death is anticipated within a year, these**

“grim reaper” calls may be as frequent as monthly. One can only imagine how a senior citizen is made to feel when those calls come in.

- **Concerned regulators, insurers and agent organizations have been advocating for enactment of state laws to prohibit these transactions for the past few years. The question most frequently asked by state policy-makers is “Who’s the Victim?” Actually, all of society pays a price, and I would like to quickly run through some of the costs of STOLI schemes.**
- **The insured senior, perhaps unintentionally, is usually participating in a fraud.**
- **In a STOLI deal, the senior may be responsible for undisclosed taxes on the economic value of the “free coverage” as well as the value of the discharge of indebtedness when the loan is repaid and any other incentives paid to them.**
- **Also, there is no guarantee that investors will buy the policy, since there are stories that with money so tight today, some seniors are now stuck with repaying the loan.**
- **The senior may be ineligible for future life insurance when needed, as the investors are holding all the coverage for which the senior will qualify.**
- **Seniors personal information, including medical records, may be shared with entities not subject to state and federal privacy laws.**
- **Insurance companies may find it necessary to restrict offering life insurance to the senior market and may be forced to raise prices for all applicants due to losses it is likely to suffer on these fraudulent sales.**

- But investors may also come up short finding that they hold a worthless security, if the policy is rescinded for violation of insurance law or fraud or if the insured lives a longer than anticipated life. Many of these “death bonds” are in pension portfolios, adding further risks for seniors and all American consumers if they do not perform.
- And, the financial markets may be exposed to yet another subprime securitization scheme – similar to sub-prime mortgages where the ongoing premium required to fund the insurance is more than the investors can or wish to fund if the insured continues to live.

Both the National Association of Insurance Commissioners (NAIC) and the National Conference of Insurance Legislators (NCOIL) have adopted Model Acts to prevent STOLI. Since 2007, 32 states have adopted measures that were intended to address STOLI. We commend you for your interest in this issue and the ACLI would be supportive if Michigan would adopt language from either of these models.

Thank you again for the opportunity to testify today. I hope the testimony provided you with the appropriate information so that you can better understand the problems associated with STOLI and its impact to all residents and in particular to seniors.